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The Annual

Report of the

Supermarket

Companies

1987-1988 ANNUAL FINANCIAL REVIEW

Conducted By:

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The Food Marketing Institute (FMI) is a nonprofit association conducting programs in research, education and public affairs on behalf of its 1,600 members -- food retailers and wholesalers and their customers in the United States and overseas. FMI's domestic member companies operate approximately 17,000 retail food stores with a combined annual sales volume of $180 billion -- more than half of all grocery sales in the United States. Most of FMI's retail membership is composed of large multi-store chains, small regional firms and independent supermarkets. Its international membership includes more than 190 members from over 50 nations.

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EXECUTIVE SUMMARY

In a year of widespread restructuring and the attendant increase in debt and interest expenses, the supermarket industry fared well by and large. Income declined slightly in the fiscal year running from 1987 to 1988. Income from operations was 1.99 percent of sales, compared with 2.14 percent in 1986-87. Higher interest expenses helped lower pre-tax income to 1.50 percent of sales (vs. 1.73 in 1986-87).

Changes in accounting policies triggered an extraordinary loss that skewed the net after-tax figure. Without the loss, operating profit was 0.91 percent of sales (vs. 0.99 percent). Extraordinary items lowered the net after-tax profit to 0.77 percent (vs. 1.12 percent).

Small companies outperformed large ones in many areas and decisively in two net income ratios, as a percentage of assets and as a percentage of net worth. Companies with less than $50 million in sales showed a net worth of 13.05 percent of sales in 1987-88, compared with 9.69 percent for those grossing $50 million-$500 million and 11.18 percent for those grossing more than $500 million. In after-tax income as a percentage of assets, the smallest group averaged 5.15 percent, compared with 3.49 percent for the middle group and 2.96 percent for the largest.

The myriad mergers, acquisitions, leveraged buyouts and asset sales affected industry debt ratios in 1987-88, as much as they did in the previous period. Total debt as a percentage of total liabilities and net worth increased to 70.88 percent (vs. 69.38 in 1986-87 and 63.37 in 1985-86). For more information, see the "Financial Statements" section.

The *Annual Financial Review* (the Review) is designed to promote a better understanding of the economics of the supermarket industry. The Food Marketing Institute (FMI) has been tracking the financial performance of the supermarket industry for the past 15 years.

The Review was conducted for FMI by Gerke Economics, Inc., a firm that has been researching the food industry since 1977. Information was derived from an extensive mail survey and public financial reports. In all, data were collected from 113 companies operating more than 12,000 supermarkets. The restructuring of major food retailers had a significant impact on the financial statements in this year's Review.

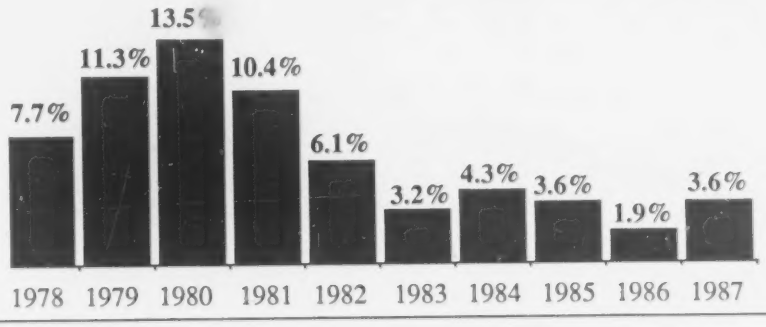
FINANCIAL DATA AND RATIOS

SELECTED ECONOMIC DATA

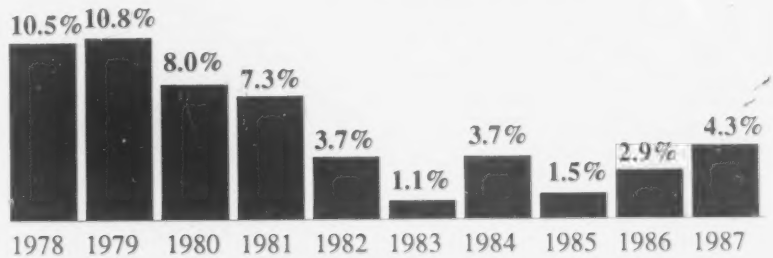
The inflation rate for the U.S. economy increased to 3.6 percent in 1987 compared with 1.9 percent in 1986. The 1987 rate is the same as that experienced during 1985. The Consumer Price Index (CPI) for food at home was 4.3 percent, considerably above the 2.9 percent in 1986 and 1.5 percent in 1985. After several years of lagging behind the overall CPI price index the CPI for food at home has exceeded the overall index for the last two years.

Interest rates for 1987 were fairly stable. The prime rate averaged 8.2 percent in 1987, slightly lower than the 8.3 percent of 1986. The 1987 prime rate was the lowest in 10 years.

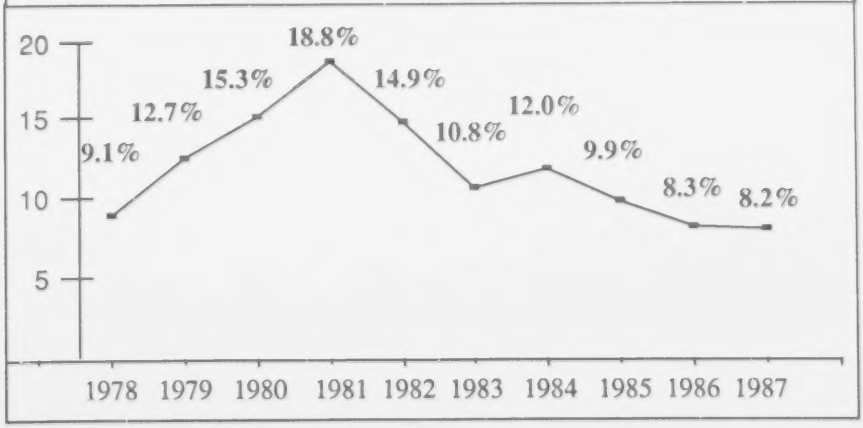
Consumer Price Index for All Urban Consumers
Annual Percentage Change for All Items (1967 = 100)



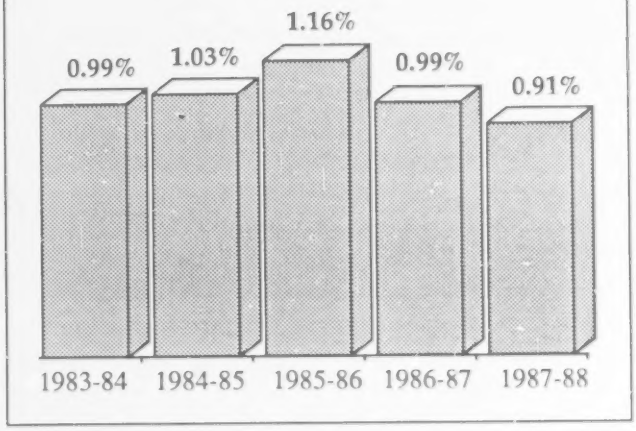
Consumer Price Index for Food at Home
Annual Percentage Change



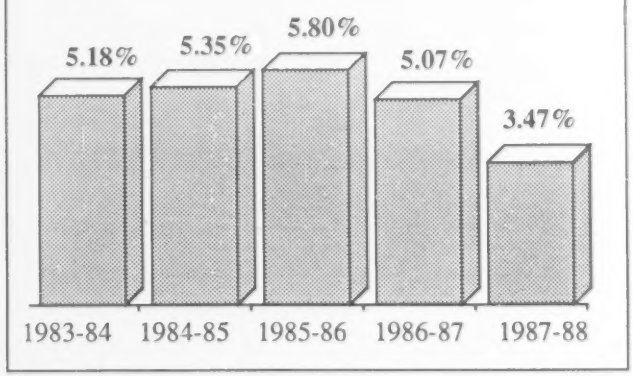
Interest Rates
Average Prime Rates Charged by Banks



Operating Profit
Net Income After Taxes and Before Extraordinary Items



Return on Total Assets
Net Income After Taxes as a Percentage of Total Assets



KEY FINANCIAL RATIOS

In measuring profitability, three financial ratios traditionally provide an overall picture of the financial health of companies:

- Net profit margin — net income after taxes as a percentage of sales. It measures the portion of the firm's sales dollar that is left after paying all expenses, including the cost of the products as well as the realization of any extraordinary gains or losses.

- Return on total assets — net income after taxes as a percentage of total assets. It measures the ability of a company's combined equity and debt capital to generate profits.

- Return on net worth — net income after taxes as a percentage of net worth. If reflects the earning power of the stockholder's equity in supermarket companies.

In these times of industry restructuring and changes in accounting procedures it is also important to examine a fourth ratio:

- Operating profit margin — the net profit after taxes but before extraordinary items. This is profit from the normal operations of the firm, including its primary business, supermarkets, and other normal items such as interest expenses, gain on sale of securities, etc. It excludes the extraordinary items; one-time transactions such as store sales or accounting changes.

For supermarket companies in 1987-88, the operating profit margin declined to 0.91 percent from 0.99 percent in 1986-87 as a result of higher interest expenses from company restructurings. The net profit margin declined to 0.77 percent, from the 1.12 percent reported in 1986-87 due to an extraordinary loss by one major chain owing to a change in accounting methods. (See the section "Changes in Accounting for Income Taxes.") In previous years, extraordinary gains, most likely from store sales, brightened the industry net-profit picture.

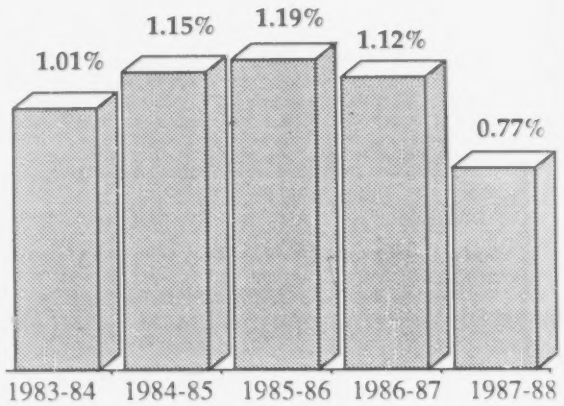
Return on total assets decreased from 5.07 percent to 3.47 percent in 1987-88, the result of lower net-profits.

Return on net worth for the responding companies dropped to 11.40 percent vs. 16.24 percent for the previous year. This reverses the upward trend in this ratio over the last few years.

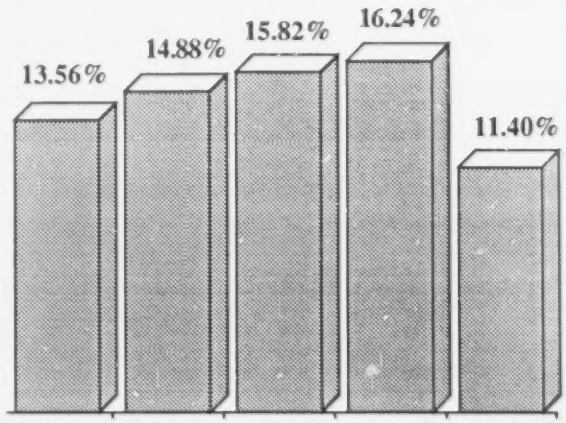
Note: The companies surveyed are divided into two size groups for purposes of calculating the overall averages:

	Net Profit	Return on Total Assets	Return on Net Worth
Less than $100 million in sales	0.73%	4.63%	12.07%
More than $100 million in sales	0.79%	2.97%	11.11%
Industry Average	**0.77%**	**3.47%**	**11.40%**

Net Profit
Net Income After Taxes as a Percentage of Total Sales



Return on Net Worth
Net Income After Taxes as a Percentage of Total Net Worth



KEY FINANCIAL RATIOS BY COMPANY SIZE

Profit ratios were calculated for three company-size categories based on annual sales of:

- Less than $50 million — small companies.
- $50-$500 million — mid-sized companies.
- More than $500 million — large companies.

The profit margin for small firms increased slightly above the 1986-87 level, while the larger firms experienced major declines in profit margins. The higher profit margin brought an increase in return on assets for the smaller firms. The mid-sized and large companies showed a decline in this ratio. All three groups experienced a decline in return on net worth.

KEY FINANCIAL RATIOS BY COMPANY SIZE

Net Profit Margin *Net Profit After Taxes and Extraordinary Items as a Percentage of Sales*				
	1984-85	1985-86	1986-87	1987-88
Sales Under $50 Million	0.78%	1.01%	0.76%	0.79%
Sales of $50-$500 Million	0.83%	0.81%	0.90%	0.67%
Sales of Over $500 Million	1.36%	1.32%	1.13%	0.79%

Return on Total Assets *Net Profit After Taxes as a Percentage of Total Assets*				
	1984-85	1985-86	1986-87	1987-88
Sales Under $50 Million	5.86%	6.90%	4.94%	5.15%
Sales of $50-$500 Million	3.97%	3.86%	3.91%	3.46%
Sales of Over $500 Million	5.75%	5.72%	4.12%	2.95%

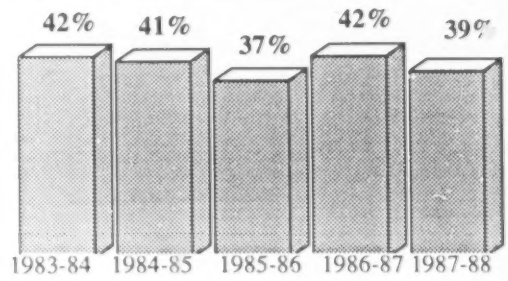
Return on Net Worth *Net Profit After Taxes as a Percentage of Net Worth*				
	1984-85	1985-86	1986-87	1987-88
Sales Under $50 Million	16.35%	19.54%	16.25%	13.05%
Sales of $50-$500 Million	11.01%	10.24%	11.90%	9.69%
Sales of Over $500 Million	15.64%	15.78%	14.81%	11.18%

TAX RATES

INCOME TAXES

The effective income tax rate paid by supermarket companies dropped in 1987-88 to 39 percent, compared with 42 percent in the previous year. Part of this decline may be due to the decreased federal corporate tax rates put in place by the Tax Reform Act of 1986. The maximum federal corporate tax rate for 1986 was 46 percent while tax reform brought it down to 34 percent in 1988 (the new and the old rates were blended in 1987).

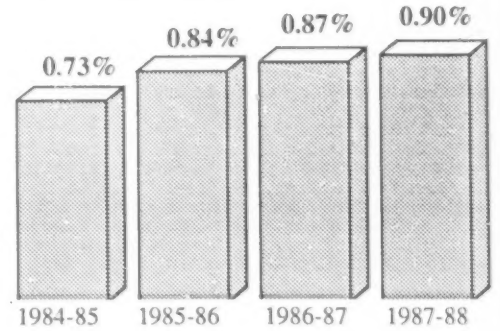
Effective Tax Rate



WAGE TAXES

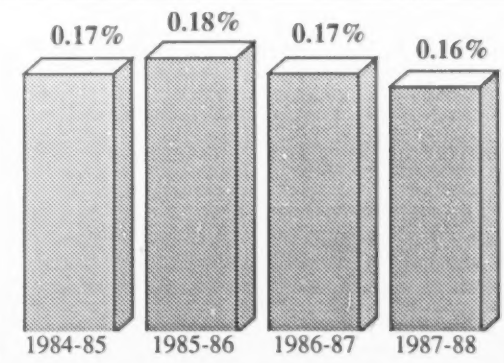
In addition to income taxes, the wage-based taxes that supermarket companies pay have become a significant cost of business. In 1987-88 supermarket employers' FICA tax payments (Social Security) averaged 0.90 percent of sales. This is an increase over the 0.87 percent paid in the prior year. The amount of FICA taxes paid by the industry exceeded its total net income for the year.

FICA Tax Payments as a Percentage of Sales



Unemployment tax payments have been fairly steady over the past four years. They averaged 0.17 percent of sales in 1986-87, dipping to 0.16 percent in 1987-88.

Unemployment Compensation Taxes as a Percentage of Sales



FINANCIAL STATEMENTS

INCOME STATEMENT

The supermarket industry's income statement had significant changes between 1986-87 and 1987-88. In 1987-88 "Cost of Sales and Operating Expenses" increased faster than sales, resulting in a decrease in operating income to 1.99 percent of sales from 2.14 percent in the previous year.

Interest expenses increased significantly from 0.61 percent of sales in 1986-87 to 0.87 percent in the most recent year. This was most likely due to the increased debt load taken on by several companies involved in acquisitions, mergers and leveraged buyouts. The result of this was a slight decline in operating profit: 0.91 percent vs. 0.99 percent in 1986-87.

For the past several years the industry had realized a net gain in "extraordinary items." In 1987-88, however, the industry had a net loss in "extraordinary items. " The primary reason was a change in accounting for income taxes adopted by one of the largest supermarket companies. (For a more detailed explanation see the section on "Changes in Accounting for Income Taxes.")

The net impact of all the changes in the income statement for the industry was a reduction in after-tax net profit to 0.77 percent of sales in 1987-88 compared with 1.12 percent in the previous period.

BALANCE SHEETS

The proportion of current assets accounted for by inventory increased in 1987-88. The most recent year's inventory level was closer to previous years, at 30.95 percent of total assets. Other current assets also increased from 3.16 percent of total assets in 1986-87 to 5.28 percent in the most recent year. Conversely, "Other Assets" (e.g. investments in other companies on long-term receivables) declined to 9.20 percent of total assets, compared with 13.18 percent in 1986-87. Other categories showed only minor changes from the previous period.

LIABILITIES AND NET WORTH

In 1986-87 there was a significant increase in total liabilities of the industry. That trend continued in 1987-88 with total liabilities rising to 70.88 percent of all liabilities and net worth for the industry.

Within the liability section of the balance sheet, there were some significant changes. The percentage of total liabilities in the form of mortgages dropped while bank loans and bonds and debentures increased significantly. These changes were probably due to the way companies handled their debt obligations as they sold off assets to reduce debt.

In the net worth section the only significant change was that retained earnings dropped to 22.59 percent of total liabilities and net worth compared with 24.39 percent in 1986-87.

FINANCIAL STATEMENTS

INCOME STATEMENT

Income Statement for Supermarket Companies (In Percentages; Sales = 100%)					
	1983-1984	**1984-1985**	**1985-1986**	**1986-1987***	**1987-1988***
Sales	100.00%	100.00%	100.00%	100.00%	100.00%
Cost of Sales and Operating Expenses	98.20	98.12	97.84	97.86	98.01
Operating Income	1.80	1.88	2.16	2.14	1.99
Interest Expenses	0.46	0.52	0.55	0.61	0.87
Other Income	0.36	0.43	0.23	0.20	0.38
Income Before Taxes and Extraordinary Items	1.70	1.79	1.84	1.73	1.50
Total Taxes on Income	0.71	0.74	0.68	0.74	0.59
OPERATING PROFIT	0.99	1.03	1.16	0.99	0.91
Extraordinary Items (Net)	0.02	0.10	0.03	0.13	(0.14)
NET INCOME	1.01%	1.15%	1.19%	1.12%	0.77%

* The financial restructuring of certain large retailers had a significant impact on the financial data in these years.

BALANCE SHEETS

End-of -Year Balance Sheet for Supermarket Companies
(In Percentages; Total Assets = 100%)

CURRENT ASSETS	1983-1984	1984-1985	1985-1986	1986-1987*	1987-1988*
Cash	6.66%	6.26%	5.17%	5.66%	5.10%
Accounts Receivable	4.33	4.24	3.91	4.24	3.67
Marketable Securities	2.78	3.35	2.76	3.52	2.32
Inventory (Note A)	31.47	31.66	31.92	27.35	30.95
Other Current Assets	3.64	2.94	3.45	3.16	5.28
Total Current Assets	48.88	48.45	47.21	43.93	47.32
PROPERTY AND EQUIPMENT (Note B)					
Land	2.93	3.80	3.92	3.59	3.74
Buildings	21.85	21.62	18.79	20.95	19.17
Fixtures and Equipment	44.07	43.52	47.88	38.56	40.71
Leasehold Improvements	10.08	10.35	9.77	10.73	9.36
Total Property and Equipment	78.93	79.29	80.36	78.83	72.98
Reserves for Depreciation	(33.23)	(33.18)	(33.93)	(30.94)	(29.50)
Net Property and Equipment	45.70	46.11	46.43	42.89	43.48
OTHER ASSETS	5.42	5.44	6.36	13.18	9.20
TOTAL ASSETS	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**

NOTE A: Some firms value at least part of their inventory on a LIFO (last-in, first-out) basis.

NOTE B: Property under capitalized leases is included in the appropriate property categories based on the type of property leased.

* The financial restructuring of certain large retailers had a siginificant impact on the financial data in these years.

End-of-Year Balance Sheet for Supermarket Companies (In Percentages; Total Assets = 100%)					
CURRENT LIABILITIES	**1983-1984**	**1984-1985**	**1985-1986**	**1986-1987***	**1987-1988***
Notes Payable	2.12%	2.17%	2.71%	5.25%	4.63%
Accounts Payable	22.68	23.39	21.63	19.00	18.38
Income Taxes Payable	1.35	1.19	1.48	1.69	0.85
Other Current Liabilities	10.40	10.18	9.78	12.97	12.76
Total Current Liabilities	36.55	35.93	35.60	38.81	36.62
LONG-TERM DEBT					
Mortgages	4.80	5.57	6.11	10.07	6.69
Bank Loans	4.67	6.78	6.95	5.18	7.45
Bonds and Debentures	2.72	2.54	3.37	4.37	8.18
Capitalized Lease Obligations	8.59	7.35	5.90	5.36	5.39
Other Non-Current Liabilities	2.69	3.16	2.61	2.41	2.33
Total Long-Term Debt	23.47	25.40	24.94	27.39	30.04
Deferred Liabilities	2.48	1.81	2.83	3.19	4.22
TOTAL LIABILITIES	65.20	63.14	63.37	69.38	70.88
NET WORTH					
Common Stock Outstanding or Proprietorship	4.19	3.62	3.95	3.74	3.44
Preferred Stock Outstanding	0.65	1.00	0.77	1.17	1.25
Paid-in Surplus	4.98	5.61	4.87	4.27	4.65
Retained Earnings	23.39	27.94	28.87	24.39	22.59
Treasury Stock	(1.71)	(1.31)	(1.83)	(2.95)	(2.81)
Total Net Worth	37.50	36.86	36.63	30.62	29.12
TOTAL LIABILITIES AND NET WORTH	**100.00%**	**100.00%**	**100.00%**	**100.00%**	**100.00%**

* The financial restructuring of certain large retailers had a significant impact on the financial data in these years.

ACCOUNTING FOR INFLATION

In past years, public supermarket companies were required to report financial results after adjusting for inflation. This requirement has been rescinded. Since supermarket firms are no longer required to report inflation-adjusted numbers the section on inflation adjustments has been dropped from the Review.

CHANGES IN ACCOUNTING FOR INCOME TAXES

The data in this Review were affected by a major accounting change. In December 1987 the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 96, "Accounting for Income Taxes." SFAS No. 96 changed the manner in which deferred taxes are put into the financial statements, triggering extraordinary items for companies making a transition from the old accounting practices to the new. All firms must start using SFAS No. 96 for fiscal years that begin after December 15, 1988. They may elect to start earlier, as did one large retailer, which began in fiscal year 1987.

Other firms will begin adopting this change in accounting for income taxes. The impact on future Reviews is not known at this time.

IMPACT OF THE TAX REFORM ACT OF 1986

The Tax Reform Act of 1986 resulted in sweeping changes in the U.S. corporate tax code. Tax rates were reduced, investment tax credits were phased out, firms were required to add capitalized expenses to their inventories, and depreciation methods were changed, to name a few of the extensive changes.

To better understand how federal tax reform affected the supermarket industry a supplemental questionnaire was included with this year's survey; 70 companies completed the supplemental questionnaire.

TAX IMPACT

The top corporate tax rate in 1986 was 46 percent. This will drop to 34 percent in 1988. The old and new rates were blended in 1987. Even though the new rate was not fully effective in 1987, just about half (49 percent) of the responding companies indicated that the lower tax rates had already had a favorable impact on company profits.

UNIFORM CAPITALIZATION

The new tax law mandates capitalization of inventories. One quarter of the firms capitalizing inventory included it in their book inventory amounts. Three quarters handled the capitalized inventories as a tax entry, only, excluding them from inventories. In those firms surveyed, the capitalized expenses amounted to 2.1 percent of total inventories.

The new tax law also required capitalization of interest in some instances. Only 6 percent of the firms surveyed indicated they were required to capitalize any interest expenses.

The uniform capitalizations requirements increased federal income taxes in the firms surveyed. On average the firms reported that their federal income tax would have been 1.7 percent less if they had not been required to capitalize inventory and interest.

The companies required to capitalize were asked if administrative costs increased and 59 percent reported they had. Most of the increased costs came for higher accounting fees.

BAD DEBT

The tax law also changed the way some firms account for bad debts. In this survey, however, only 3 percent experienced increased income tax expenses because of the requirement to change from the reserve method for bad debts to specific write-off method.

CALENDAR YEAR

The new tax law required certain types of organizations to switch to a calendar year, affecting 7 percent of the firms reporting in this survey.

DEPRECIATION

The tax law also changed the depreciable life on certain assets. As a result 10.4 percent of the gross amount reported as buildings or building leasehold improvements were required to be depreciated over 31.5 years.

METHODOLOGY

The Review was developed from two primary sources of data: a survey mailed to the FMI members and annual reports filed with the SEC on FORM 10-K.

For 1987-88, much of the financial data were supplied by the companies that responded to the survey. Data were not used for any company with sales of less than $2 million per store. Only firms with at least 50 percent of revenues from supermarkets were included in the sample.

Data for several large publicly traded companies were obtained from annual reports filed with the SEC. In all, data were collected from 113 companies that operated 12,022 stores. These firms accounted for sales of $128 billion. The sample included:

- 44 companies with sales of less than $50 million, 30 companies with sales of $50-$500 million and 39 companies with sales of more than $500 million.

The sample size in this survey varies from year to year, especially among the smaller firms. Some of the year-to-year changes in profitability may be due to a change in the companies responding to the survey.

The Review samples supermarket companies. These companies may obtain some of their revenues from sources other than supermarkets. In the 1987-88 sample, the smaller companies (sales of less than $50 million) generated 97.9 percent of their revenues through supermarkets. The mid-sized companies ($50-$500 million) generated 99.9 percent of their sales from supermarket operations. On average, the larger firms in the sample (more than $500 million) generated 96.5 percent of their revenues from supermarkets.

Financial data were collected for company fiscal years ending between April 1, 1987, and March 31, 1988.

In order to develop the industry averages, means were calculated for each category and weighted using data from the 1982 Census of Retail Trade. The Census data are shown in the table on the following page. The stratification and weighting of data help eliminate year-to-year changes that result from changes in the survey sample.

We believe this method of developing average financial estimates for supermarket companies provides the best published measurement of trends in the supermarket industry's capital structure. It does not, however, totally eliminate the problems of changes in sample size and varying fiscal year ending points.

*Supermarket Population Based on 1982 Census of Retail Trade**			
Firm Sales (millions)	**Percentage of Total Firms**	**1982 Sales**	**Percentage of Total Sales**
Less than $100	97.4%	$ 57,792,633	30.25%
$100 and Over	2.6	$133,792,115	69.75%
	100.0%	$191,060,748	100.00%
*Source: U.S. Census Bureau (latest available data)			

DEFINITIONS

SELECTED BALANCE SHEET CAPTIONS

Inventory includes all goods held for sale by supermarket companies. Some firms value inventories on a first-in, first-out basis (FIFO). Others use a last-in, first-out basis (LIFO) valuation. For the Review, the inventories are recorded as reported by the surveyed companies.

Other Current Assets include all assets (except inventory) with a defined life of less than one year (e.g., cash, accounts receivable, prepaid expenses, short-term investments).

Net Property and Equipment is all property, plant and equipment, including capital leases, less accumulated depreciation and amortization.

Other Assets include all assets (except property and equipment) with a defined life of greater than one year (e.g., investments in other companies, long-term receivables).

Current Liabilities include all debts and expenses that are due within one year (e.g., accounts payable, accrued liabilities, current portions of long-term debt).

Long-term Liabilities include all debts and expenses that are due after one year (e.g., long-term debt, capital lease obligation, deferred taxes).

Net Worth is the difference between total assets and total liabilities. It typically comprises stock, paid-in surplus, retained earnings and treasury stock.

SELECTED INCOME STATEMENT CAPTIONS

Sales represent all sales reported by supermarket companies.

Cost of Sales and Operating Expenses includes the cost of merchandise sold by supermarkets plus all other expenses of operating the stores, distribution facilities and the central office.

Interest Expense includes all interest charges on short- or long-term debt and on capital lease obligations.

Other Income includes all non-operating income (e.g., interest income, gain on sales of securities).

Total Taxes on Income are the federal and state taxes imposed on the supermarket companies which are based on net income as reported to the government.

Extraordinary Items include all financial events that occur infrequently and are unusual (e.g., provisions for the disposition of facilities, realization of tax loss carry-forwards, changes in accounting procedures).

RATIOS

Operating Profit Margin is the ratio of income after taxes but before extraordinary items.

Net Profit Margin is the ratio of net income to sales.

Return on Total Assets is the ratio of net income to total assets.

Return on Net Worth is the ratio of net income to net worth.